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DIRECTORATE OF  
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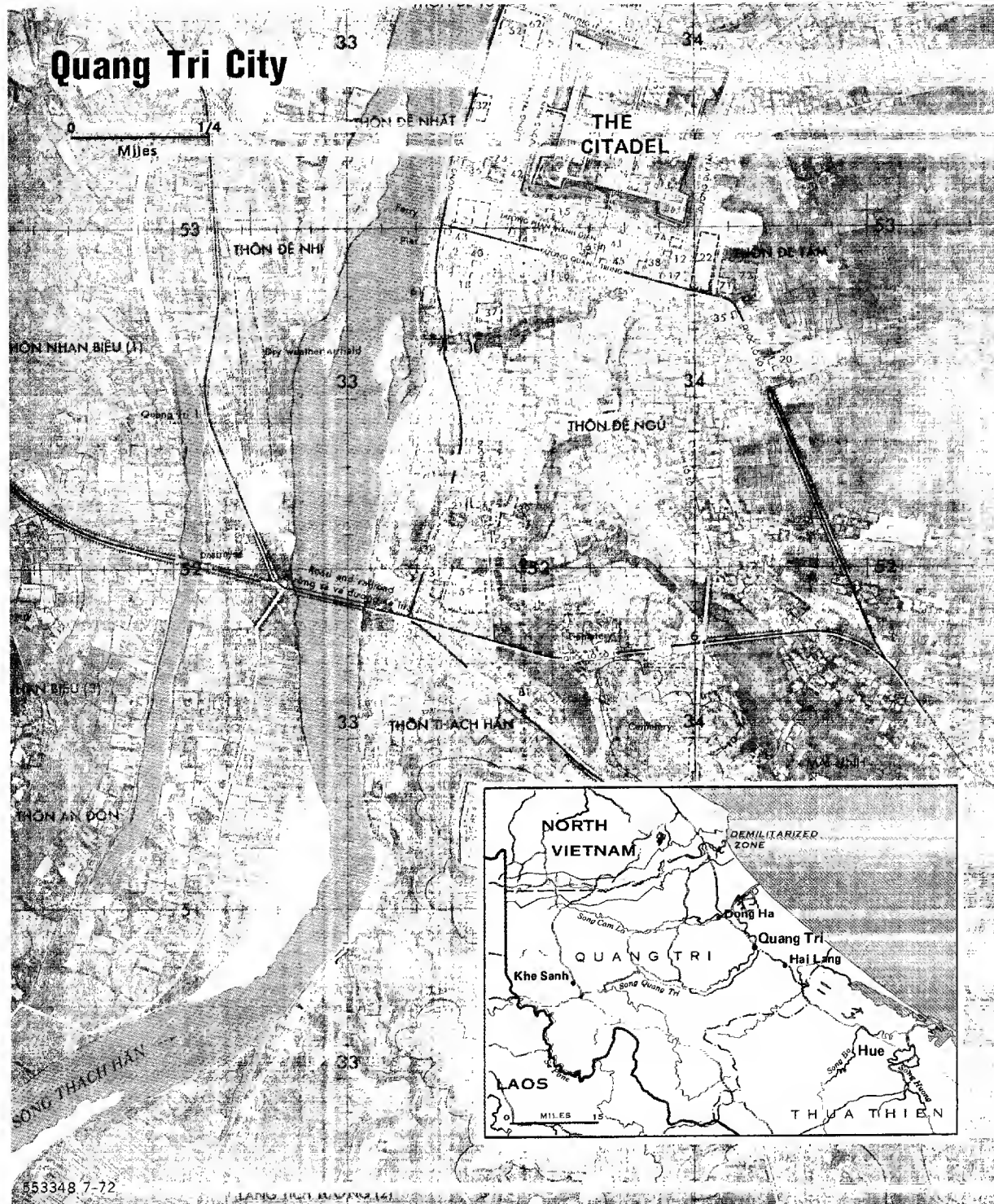
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**SOUTH VIETNAM:** South Vietnamese paratroops moved into the Quang Tri City citadel yesterday; the Communists apparently are preparing new positions north and west of the city.

Some South Vietnamese military spokesmen claim the citadel is now under full government control, but this has yet to be confirmed. The fortress is the key to control of the provincial capital, which was seized by the Communists on 1 May. The loss of Quang Tri City would be a major psychological setback to the Communists, although they appear to be reforming their defenses in the province and preparing for further action.

Action elsewhere in the northern provinces remains fairly heavy. Communist gunners fired more than 1,300 artillery and mortar rounds at South Vietnamese defensive positions south and west of Hue on 24 July and shelled the Hue citadel for the second day in a row. The South Vietnamese are continuing their push into northern Binh Dinh Province and are now deploying at least company-sized units in all three districts that were taken by the Communists earlier this spring. In Military Region 3, South Vietnamese engineers have not yet cleared Route 13 south of An Loc of mines and debris, but the road is officially open and some light traffic is moving.

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JAPAN-US: Prime Minister Tanaka is clearly determined to redress Japan's growing trade imbalance with the US.

Tanaka views an easing of economic strains as a vital step in strengthening Tokyo's ties with Washington, and he would undoubtedly like to deflate the trade issue before his meeting with President Nixon next month. Plans to increase purchases from the US and to liberalize foreign access to Japanese markets have been discussed for several weeks in Tokyo in preparation for the bilateral trade negotiations now under way. In addition to proposals for large-scale purchases of American grains and safeguarded enriched uranium, Tokyo is considering increased imports of US commercial aircraft and military hardware. It may also expand import quotas on foodstuffs and computer products and ease restrictions on foreign investment in retail and wholesale outlets.

Conflicting bureaucratic and business interests, which in the past have often precluded significant trade concessions, must still be resolved. Some higher echelons of the Ministry of International Trade and Industry, together with the foreign and finance ministries, favor import liberalization, but they face strong opposition from middle-level bureaucrats who represent business and agricultural interests. Tanaka is in a stronger position than former prime minister Sato to gain concessions and to weather the controversy that might follow the imposition of liberalization programs.

Even if the prime minister obtains agreement to offer the US some of the concessions under consideration, they are not likely to have any major impact on the trade balance this year. Because of logistical problems, large-scale purchases could at most boost imports from the US by only a few hundred million dollars. Other trade and investment

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measures being considered represent only a continuation of Tokyo's policy of gradually opening up the domestic market, which will have only a long-term effect on the trade balance. [REDACTED]

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CHILE: In a long-heralded major speech on the country's economic problems, President Allende acknowledged important difficulties, promised the workers a larger share of goods and services, and warned of future sacrifices.

The President first pointed out positive aspects of his economic policies--increased employment and industrial growth--but quickly turned to the major problems facing the nation. Prime among these is the shortage of foreign exchange, attributed to lower copper prices, large debt payments, and a US withholding of private and governmental credits.

Allende praised Latin America, Japan, Europe, and especially the Soviet Union for coming to Chile's aid with needed loans and credits. Allende admitted, however, that these were insufficient to balance losses caused by the disruption of traditional economic patterns. As a partial remedy, Allende prescribed a savings plan that would provide local investment funds and a soak-the-rich pricing scheme. A general wage boost, to take effect in October, was also announced, along with a vacation plan, designed to give workers a domestic paid holiday. Guarantees against expropriation were offered to small businessmen and farmers. Lest some take his optimistic tone too seriously, however, Allende warned of further belt-tightening.

While the general outline of his programs had been previously discussed, the specifics are new. The government's performance to date and accelerating economic pressures suggest that implementing this policy will be difficult at best. Successful or not, more stringent government controls on the economy and on the spending habits of consumers seem certain. The speech is one more aspect of the preparations for the legislative elections less than eight months away. Attacks on the US and the local oligarchy, not now belabored, are likely to grow if the economy does not improve.

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EUROPEAN COMMUNITIES - MIDDLE EAST: The EC continues to show cautious interest in measures that might increase its long-term involvement in the Middle East.

A long-discussed plan to provide community assistance to Palestinian refugees came up again last week in The Hague in the EC forum for political consultations. The plan, prepared by the EC Commission, calls for spending \$30-40 million over a three to five - year period for food, education, and development aid. The political directors at last week's meeting agreed that an early decision could be taken to move ahead with the food program, which could be justified on a humanitarian basis. Because of the political implications involved, however, action on the remainder of the plan was deferred until September, when it will be discussed by the foreign ministers of the Ten.

Action taken by the EC Council last week should permit the community to conclude this month the preferential agreement with Egypt that has been under negotiation for two years. A trade agreement probably will also be concluded with Lebanon soon, and Jordan has requested negotiations on a similar agreement. Syria's relationship to Europe is now scheduled to be taken up later in the context of the community's political consultations. The EC is discussing with Israel an updating of the existing preferential arrangement.

While the EC as such can be expected to go slow in extending its involvement in the Middle East much beyond the commercial sphere, its network of trade arrangements there and in the Mediterranean will contribute to its "presence." Moreover, the view is widely held by community members that Western Europe's influence in the area is not now commensurate with its vital security and economic--especially oil--interests. This view should sustain interest in the still tentative efforts to develop common policies toward the area.

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UK: The underlying issues between the Heath government and the labor unions remain unresolved.

The jailing of five London dockworkers last weekend under provisions of the controversial Industrial Relations Act was the immediate cause of the walkouts that have shut down all UK ports and affected other sectors of the economy. The official solicitor, who acts independently of the Tory government, has announced that he will intervene in the case. This could get the dockworkers out of jail soon and diminish the protest strikes. The fundamental issue for the government, however, is whether it can enforce the law.

The Tories hoped the Industrial Relations Act would provide a legal framework for establishing an orderly pattern of labor-management relations. Instead, left-wing labor elements have forced numerous confrontations between the trade union movement and both the National Industrial Relations Court and the government. For example, the Trades Union Congress leadership is not expected to endorse demands for a one-day general strike on 31 July, but widespread wildcat industrial action could still occur. Despite heavy pressures, Prime Minister Heath has given no sign that he is prepared to consider union demands for suspension of the new law until it is given a chance to work.

The government, whose standing in public opinion polls has slipped severely in recent months, has been hampered by its inability to mobilize traditional British respect for the rule of law against union attempts at coercion. The hand of labor moderates, who recognize the need for reform and cooperation with the government, would be strengthened if the government were able to bring the pressure of public opinion to bear on left-wing union leaders.

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The economic impact of the strikes at this time is relatively minor. Sterling, though down slightly on international foreign exchange markets, has not been subject to hectic trading, and London stock prices have stabilized after a small loss. No serious shortages of consumer goods or industrial materials have occurred.

If the strikes continue, however, the UK economy would be seriously affected. Because Britain depends heavily on imports for food and industrial materials, a prolonged dock walkout would soon cause shortages and industrial slowdowns, and boost consumer goods prices--especially on food. More importantly, a lengthy dock strike would probably lead to loss of markets for British exporters. Customers abroad would have to find alternative sources to meet current requirements. Furthermore, after the strike, many might hesitate to resume ordering from Britain so long as the unions retain the potential to interrupt the orderly flow of goods. [REDACTED]

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SPAIN: After extensive disorders during the past academic year, which resulted in the closure of several key universities, the regime has issued new decrees extending its control over universities.

One decree permits the government, at the request of the education minister, to suspend temporarily the normal statutes of any university whenever a threat to academic order exists. The government can then issue such provisional rules as it wishes. Such a measure is in accord with the regime's tendency to provide a legal basis for harsh control measures.

A second decree provides that, upon recommendation of the education minister, the government can appoint university rectors. The regime can thereby ignore the opinion of the faculties in choosing a replacement for a rector who opposes government intervention in campus disturbances. The decrees, not yet published officially, are also expected to include a wide variety of disciplinary measures against students.

In June, strict disciplinarians replaced ranking Education Ministry officials who were responsible for the educational reform program over the last two years. The changes made clear the government's determination to avoid serious academic disorders in the upcoming term.

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INDIA: The take-over of one of the two remaining privately owned major steel firms gives New Delhi control of 75 percent of the country's steel capacity.

The government justified its take-over of the Indian Iron and Steel Company (IISCO) by citing the continued decline in production, poor maintenance and management, and increasing operating costs. The firm is now operating at 60 percent of its one-million ton capacity. Two of India's three publicly owned steel plants, however, have been plagued with similar operational difficulties and are currently operating at lower rates of capacity than IISCO. The steel industry's difficulties stem in large part from labor indiscipline and the government's failure to permit adequate imports of equipment and supplies. Moreover, without operational improvements and labor management reform, steel production cannot be substantially increased.

Of the five major steel plants in the country only the Tata Iron and Steel Company remains in private hands. Indian officials have stated that this firm is not likely to be taken over. [REDACTED]

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CHINA-EGYPT: Peking has given cautious official support to President Sadat's decision to request the withdrawal of Soviet advisers. A joint message of congratulations on Egypt's national day from acting chief of state Tung Pi-wu and Premier Chou En-lai refers to Sadat's speech of 18 July as expressing Egypt's strong determination to fight for justice. The message also pledges the support of the Chinese Government and people for Egypt's struggle to oppose "the aggression committed by Israeli Zionism with the connivance and support of the superpowers." This vague statement does not commit Peking to any particular course of action, but it leaves the Chinese free to take advantage of the developing situation. Having profited from Moscow's discomfiture in the Sudan last year, the Chinese presumably now hope to achieve similar political gains in Cairo. [REDACTED]

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WEST GERMANY: US hopes for EC trade liberalization have received welcome support from a West German trade association that represents more than 100,000 business establishments. The association recently published a series of proposals designed to counter the accelerating increase in living costs, which reached an annual rate of 8.4 percent in June. It called on the government to help boost imports by advancing the date for reduction of duties on imports from the four countries soon to join the EC. The association also called for an earlier-than-planned reduction in the EC's external tariffs, and the removal of nontariff barriers. Although these proposals are somewhat unrealistic in the EC context, they serve as a reminder that important interests within West Germany continue to favor trade liberalization. [REDACTED]

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PANAMA: A Review of Recent Political Developments

The focus of political activity in recent months has shifted from negotiation of a new canal treaty to the legislative elections to be held on 6 August, the first expression of the popular will since the coup in 1968. Nevertheless, preoccupation with Panama's international image remains at the core of government policy. Deeply concerned that the country is considered merely an appendage of the US, the current regime is flaunting its nationalism and of late has inched toward an independent, "third world" position.

Government moves toward an independent foreign policy stance have been many and varied. Panama maintains commercial ties with Yugoslavia and Poland and last year opened formal diplomatic relations with Romania. It is deliberately expanding commercial, sports, and cultural ties with Communist states and strengthening its informal ties with Cuba. It recently supported the Peruvian initiative to reduce OAS sanctions against Cuba and reportedly supported Cuban participation in the Caribbean Law of the Sea Conference held last month in the Dominican Republic.

All of this posturing is, of course, secondary to the canal treaty negotiations. The Torrijos government is determined to gain increased compensation, a reduction in the US military presence, full jurisdiction over the Canal Zone, and the return of a significant portion of the 647 square miles of land and water area. However, nearly 13 months after the current round of negotiations began, little progress toward a new treaty has been made. Indeed, the last formal negotiating session was in late March. In large part, this extended recess results from Panama's difficulty in drafting a counteroffer.

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The main stumbling block has been General Torrijos, who has been unwilling to commit himself on major treaty issues. Those working out the Panamanian position have been caught in a bind. On the one hand, they feared their patriotism would be questioned if they were too reasonable. At the same time, the negotiating team seemed to recognize that a position meeting the expectations of all shades of Panamanian opinion would not advance the negotiations. Although an agreed negotiating position will probably be reached soon, it is unlikely that Panama will compromise its objectives, and its hopes for fruitful negotiations will continue to center on gaining further US concessions.

The Panamanians periodically have attempted to enlist international support of their treaty objectives and will continue to use selected international forums for such efforts. At least for the next few months, however, a serious attempt to generate pressure on the US or to inflame domestic opinion on the canal issue seems unlikely. Although formal negotiation may soon resume, Panama's leaders believe that little can be accomplished on the treaty until after the US elections in November and that it is in their interest to wait. Torrijos, moreover, is currently preoccupied with promoting the legislative elections. After that, he may be primarily concerned with ironing out the political details associated with transforming the current provisional junta government into a constitutional government.

On 6 August, the voters will elect 505 representatives to a new national legislature that in turn will select the next president and vice president and approve a new constitution. Although these events are being billed by the government as highly significant, the public has found no issues to arouse its interest and even candidates have been hard to find. The government has blocked the

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participation not only of the old politicians but of any opposition at all, and the electorate knows that General Torrijos will wield as much power after the election as he does now. Even speculation that significant personnel shifts might occur has ebbed as Torrijos' speeches have hinted that he will remain as National Guard Commandant and that President Lakas will continue in his present post.

The electoral exercise will nevertheless serve to demonstrate the government's power and its continued ability to stage manage political events. Local institutions will probably be strengthened and a needed link between the national government and the people will be created. It may also enhance government authority to push ahead with domestic reforms. From Torrijos' point of view, moreover, the election will reaffirm to the world Panama's political stability and give his rule a new legitimacy and respectability which he hopes will strengthen his hand in negotiations with the US.

Torrijos realizes the need to maintain an atmosphere conducive to negotiations and to keep US-Panamanian relations on an even keel. Nevertheless, he remains suspicious of US motives. A fervent nationalist, he is quick to react to real or imagined slights. Although he always draws back from moves that would irrevocably impair relations with the US, he has a thorough appreciation of the use of harassment techniques that inject just the right amount of strain in bilateral relations. Recently stung, for example, by charges that Panama has not done all it could to stop narcotics traffic, the Torrijos government suddenly began rigid enforcement of Panamanian immigration laws to the considerable discomfort of US travelers and of dependents of US officials serving in Panama.

Torrijos' need to demonstrate his independence from the US and to revalidate his nationalistic credentials manifests itself in other ways. Although

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he very cordially received visiting members of the US National War College in April, he reportedly fired the National Guard publicity chief for publicizing this cordiality.

More important has been the government's handling of its feud with the US-owned power and light company. Although Torrijos had little interest in taking on a new and expensive burden and did not wish to scare off foreign investors, he reacted sharply to pressure tactics that threatened to disrupt electric service. The original 30-day government take-over of the company was designed to force compliance with Panamanian laws and ensure an adequate investment program to keep up with growing power requirements. Even though the company made an effort to meet Panama half-way, rigidities on both sides prevented a solution. Very favorable press and public reaction to the government move, moreover, apparently made Torrijos less and less willing to back down. Arguments by President Lakas and others about adverse economic and international repercussions did not diminish Torrijos' interest in milking a nationalistic issue, and the decision was made to acquire the company by the end of August.

Despite the revolutionary rhetoric, the openings to the left, and the cooperation with the local Communist party, Torrijos retains a basically pragmatic rather than ideological orientation. While "social justice" and improvement of the lot of the rural poor will continue as important government goals in the short run, Torrijos' preference for the big picture, the glamorous issue rather than the hard work and drudgery of governing, may limit domestic progress. He may attempt to play a larger role on the world stage as a progressive, if not slightly radical Latin American leader with good channels to third world and Communist states.

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The real test, of course, will be Torrijos' ability to obtain a new canal treaty. If he achieves an agreement that can be readily sold to the Panamanian public, his place in Panamanian history will be assured. A failure, however, could finish him politically. Torrijos' reluctance thus far to involve himself personally in the negotiations may reflect a continued fear to cast the die. [REDACTED]

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